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FEATURED Q&A

How Will New Pension Fund Reforms Play Out in Mexico?

Q With regulatory changes intended to pressure Mexico's Afores pension fund companies to seek higher returns for their clients scheduled to go into effect next month, at least one player (Monex) has left the market, while there has been a good deal of consolidation among other players (ING-Santander, MetLife-Actinver). Are the Afores prepared for the implementation of the regulatory changes next month? Will the changes have the intended results?

A **Guest Comment: Vicente Corta:** "The main goal of this regulation is to effectively motivate those Afores that have been conservative to have more active management and diversify their investments. The Afores have two big challenges. The first is to

that is, how they are designed for different age groups with different risk profiles ... Without a doubt, given changes in the way commissions will be charged, a period of further consolidation is coming. Thus, in upcoming months and years we will see fewer participants, but greater presence in the market. Another challenge for the pension fund system is investment diversification—and here there are several important players. First are the fund managers, which must effectively utilize resources and ways to diversify their portfolios as the investment regime permits. Second is the regulatory authority, Consar, which should keep moving forward to open more investment

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FEATURED PHOTO



ING agreed to sell part of its insurance business to AXA to focus on pensions and annuities, which ING Americas CEO Tom McInerney (above) says have great potential in the region. See story on p. 2.

Photo: ING

“In my personal opinion, I think they should raise the 20 percent limit on international investment.”

— Former Consar head Vicente Corta

open the five funds, and there is an additional administrative cost in having five Siefores ... The second big challenge for both fund managers and the system is to inform workers about what Siefores do,

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NEWS BRIEFS

**BM&F and Bovespa
in Merger Talks**

Brazilian futures and commodities exchange **Bolsa de Mercadorias e Futuros-BM&F** has entered exclusive talks to merge with the **Sao Paulo Stock Exchange**, a move that would mirror similar combinations in Canada and Australia in recent years, Bloomberg News reported on February 20. As of that date, BM&F had lost \$4.19 billion in market value since going public last November.

**Reinsurer Swiss Re
to Open Unit in Brazil**

Zurich-based reinsurer **Swiss Re** is creating a unit in Brazil to take advantage of the government's plans to open up the local reinsurance market to foreign competition, Bloomberg News reported on February 19, citing the unit's CEO, Henrique Oliveira. Reinsurers **Munich Re** and **Lloyd's of London** have already announced plans to start operations in Brazil, where the government plans to phase out protection for state-run and local reinsurers by 2013. Oliveira expects reinsurance revenue in Brazil could double by then to \$2.5 billion.

**Morgan Stanley Names New
Regional Head for Latin America**

US investment firm **Morgan Stanley** named Christopher Harland its regional head in Latin America, replacing Guillermo Jasson, as the company increases its focus on emerging markets. The 50 year-old Harland, previously chairman of Morgan Stanley's global media and communications group, will be based in New York and join the firm's management committee, according to an internal memo cited by Bloomberg News.

Insurance News

**ING Sells Mexican Insurance
Business to AXA for \$1.5 Billion**

Dutch banking giant **ING** said February 13 it agreed to sell part of its Mexican insurance business to Paris-based **AXA** for about 1 billion euros (\$US 1.5 billion) so it can focus on its annuities and pension businesses in Latin America, Bloomberg News reported. AXA, Europe's second-largest insurer, will take over **Seguros ING** and its subsidiaries, which represent ING's property and casualty, and auto insurance lines, plus its health and life insurance lines. The deal is subject to regulatory approval, and is

“We believe we can leverage our know-how to restore ING Seguros' growth and profitability.”

— AXA head *Henri de Castries*

expected to close during 2008. Seguros ING is Mexico's third-largest insurer, with 5.5 million clients and a 12 percent market share. Its units employ about 4,200 people, and the majority of them will transfer to AXA. "This acquisition gives us a leading position in a large growth market on attractive conditions, as we believe we can leverage our know-how to restore ING Seguros' growth and profitability," said Henri de Castries, AXA's chairman and CEO. AXA said it expects Seguros ING to post revenue of about \$1.9 billion for 2007. ING expects



McInerney
Photo: ING

to book a capital gain of 150 to 200 million euros from the divestment, and be able to focus on other areas. "We see a great potential to grow ING's pension and wealth management businesses in Mexico and in the rest of Latin America," ING's CEO for the Americas, Tom McInerney, was quoted as saying. ING runs Mexico's third-largest pension provider, the com-

pany said. Last year, it paid Spain's **Banco Santander** \$1.6 billion for its Latin American pension and annuity operations, making it the biggest pension fund manager in the region after Spain's **BBVA**. Mexico will implement new pension fund reforms on March 15, which are partly intended to create more competition in the market. Carlos Muriel, head of ING Americas' insurance unit, said recent pension fund reforms in Mexico are "a positive change," Mexico's *El Semanario* reported on February 18. [Editor's note: see related Q&A on page 1.]

Remittances News

**MoneyGram Agrees to Sell Majority
Stake to Private Equity Group**

Money transfer giant **MoneyGram International** announced February 12 that it would sell off a majority stake in the company to private equity firm **Thomas H. Lee Partners** (THL) and investment bank **Goldman Sachs**, Reuters reported. The Minneapolis-based payment services company said it would sell an approximately 63-percent equity interest for about \$710 million. Goldman Sachs agreed to provide debt financing of up to \$500 million, MoneyGram said, noting that it expects to get an additional \$200 million in debt financing before the sale closes. In December, **Euronet Worldwide** made an unsolicited offer to buy MoneyGram for \$20 a share, or \$1.65 billion, but the two parties did not begin talks because they failed to agree on terms. Now, the deal with THL and Goldman has a "go shop" provision under which MoneyGram can seek alternative proposals, including from Euronet, until March 7. In January, MoneyGram had said that, in a bid to make its investment portfolio less risky, it was mulling a recapitalization plan to sell as much as 65 percent of its equity to an investment group, according to Reuters. The company also said on February 12 that it sold \$1.8 billion in investment portfolio securities, of which \$1.3 billion were asset-backed securities that had been previously announced. This sale resulted in a loss of about \$380 million, according to Reuters.

Banking News

Banco Itau Posts 59 Percent Growth in Q4 Profit on Lending Expansion

With record-low interest rates fueling a continuing credit boom in Brazil, **Banco Itau Holding Financeira**, the country's largest non-government bank, saw profit rise 59 percent in the fourth quarter of 2007, Bloomberg News reported on February 12. Banco Itau's net income grew to 2.03 billion reais (\$US 1.5 billion) from 1.28 billion reais a year earlier on higher lending and one-time gains from the sale of stakes in two stock exchanges. The Sao Paulo-based bank's core earnings were down 5 percent quarter-on-quarter due to higher "other tax expenses," a 40 basis-point compression in net interest margins, and higher non-interest expenses, **JP Morgan** noted in research on February 12. The investment bank research pointed out that Itau is displaying similar positive trends as rival **Banco Bradesco**, Brazil's second largest private bank, such as loan growth and asset quality. With lending in the Brazilian market growing its fastest in 12 years in December, Itau's credit portfolio expanded 36 percent year-on-year in the fourth quarter to 127.6 billion reais. Excluding lending in **Bank of America's** Chilean and Uruguayan units, which Itau acquired last year, the Brazilian bank's credit portfolio expanded almost 28 percent. Itau gained 241 million reais from the sale of stakes in the **BM&F** commodities and futures exchange and in **Bovespa Holding**, which owns Sao Paulo's stock exchange. Both bourses went public in the quarter. For the full year, Itau's profit nearly doubled to 8.47 billion reais from 4.3 billion reais a year earlier. The company's shares fell 1.3 percent in the fourth quarter compared to a 5.7 percent increase at rival Bradesco. Bradesco said late last month its profit rose 29 percent in the fourth quarter to 2.19 billion reais.

Unibanco's Fourth-Quarter Profit Rises 44 Percent to 827 Million Reais

Brazil's **Unibanco** on February 14 posted an 827 million-real (\$US 474 million)

Argentine Earnings Highlights

Banco Macro's Profit Grows 15 Percent

Argentina's **Banco Macro** said February 19 that it posted fourth-quarter net profit of 169 million pesos (\$US 53 million), a 15 percent increase over the same period a year ago, according to Reuters. The bank, one of Argentina's largest private financial institutions, said in a filing with the **Buenos Aires Stock Exchange** that it recorded better net financial income due to higher-valued government debt and higher interest rates on loans, as well as more income from services. Consumer lending led the gains. Macro's private sector lending jumped 63 percent, or by 3.8 billion pesos, between the end of 2006 and the end of last year, Reuters reported. In comparison, private sector lending in the whole banking system grew 42 percent.

Galicia Gains 51.4 Million Pesos in Fourth Quarter

Compared to a big loss in the fourth quarter of 2006, **Grupo Financiero Galicia** earned a 44.6 million-peso (\$US 14 million) net profit in the fourth quarter last year, Reuters reported. The conglomerate said the results were mostly due to performance at **Banco Galicia**, its main unit, and at its insurance company, **Sudamericana Holding**. Banco Galicia, which last year finished paying off the debt it owed the Argentine central bank for bailing it out of the 2001-02 economic crisis, made a net profit in the period of 51.4 million pesos, compared to a loss of 108.9 million pesos a year earlier. The bank's private sector lending was up 32 percent compared to the end of 2006, with small-business loans increasing 58 percent and consumer lending up 48 percent.

Argentine Financial System Profits Drop 8.5 Percent YoY

Profits across Argentina's financial system dropped in 2007 compared to a year earlier due to higher administrative costs and third-quarter financial turbulence, the central bank reported on February 14, according to Reuters. Last year's bank profits fell 8.5 percent year-on-year to 3.94 billion pesos (\$US 1.24 billion). Last year, 86 percent of Argentine banks recorded profits, and about 63 percent of those were private institutions. It was the third straight year of profits in the country's banking system, which sustained huge losses during the 2001-02 economic crisis. Deposits in the banking system reached 12.99 billion pesos, up 22.6 percent in 2007.

fourth-quarter profit, up 44 percent from the same period a year earlier, Reuters reported. Unibanco said earnings for the quarter were boosted by a 382 million-real gain from the sale of its stakes in **Bovespa Holding** and the **BM&F** commodities and futures exchange. Excluding the one-time gain from the sale of the stakes, Unibanco's fourth-quarter profits would have risen 24 percent year-on-year to 715 million reais. The bank's average annualized return on equity, a measure of profitability, rose to 26.8 percent in the fourth quarter from 25.8 percent a year earlier. The bank's loan portfolio expanded 35 percent year-on-year to 61.4 billion

reais, as record-low interest rates continue to spur increased borrowing, according to Bloomberg News. Lending to individuals increased 50 percent, fueled by growth in payroll-deductible loans, which more than doubled, while auto loans almost doubled. Business lending rose 26 percent. Unibanco CEO Pedro Moreira Salles said the bank lowered its forecast for lending growth this year to 20-22 percent after a previous forecast of as much as 30 percent, due in part to an increase in January in taxes on financial transactions. For full-year 2007, Unibanco reported net income of 3.45 billion reais, nearly double the previous

year. The bank plans to open 200 new branches this year, compared with about 50 last year, according to Bloomberg News.

Political News

Despite Fidel's "Retirement," US Sees No Change in Policy Toward Cuba

The US does not expect to alter its policy toward Cuba, including its decades-old economic embargo against the island, in the wake of Fidel Castro's retirement, US State Department spokesman Sean McCormack said February 19. "There's no change in our policies. I don't believe that there is [any] contemplated at this point," McCormack told reporters. In a letter published in Cuban state media early on February 19, the 81 year-old Castro, who has ruled the country for nearly 50 years, announced he was stepping down, saying his health would not allow him to take on the responsibilities of head of state. Castro has not been seen in public, except in occasional images released by state media, since provisionally ceding power to his 76 year-old brother, Raul Castro, in July 2006 in order to undergo intestinal surgery. Raul, who is expected to permanently take over the leadership of the country in the wake of his brother's announcement, is seen as more pragmatic than Fidel, and his ascension to power has raised hopes for a possible thaw in relations between Cuba and the United States, which has maintained a four-decade economic embargo against the island. However, McCormack said there was "no real difference" between the governments headed by Fidel and Raul Castro. "They continue to crack down on individual civil liberties, ignore basic human rights, and basically impose a system of [government] on the Cuban people as opposed to being open to allowing them to define their own future," McCormack stated. In related news, the leading candidates in the US presidential election all issued statements on February 19 on the news of Castro's stepping down. Republican Senator John McCain said "Cuba's democratic transition is inevitable" and that "America can and should help hasten the sparking of free-

Comings & Goings

New Orleans-based **Pan-American Life Insurance Company** on February 15 named **Robb Suchecki** as its new vice president for Latin American regional operations. Based in Panama, Suchecki will oversee the company's health insurance operations in Latin America, primarily supervising the healthcare operations division, as well as overseeing regional directors in Colombia, Ecuador, El Salvador, Guatemala, Honduras, and Panama. Most recently Suchecki was a consultant with **Redbridge Network & Healthcare**, and before that held positions with **MMF Systems** and **HNA Panama**. The Pan-American Life Insurance Group serves nearly half a million customers in the Americas.

Citigroup said last month that it hired **Jaime Yordan** as vice chairman of global banking for Latin America. Yordan worked at **Goldman Sachs** from 1990 through 2005 and before that he ran Latin American banking at **JP Morgan**. Yordan will report to Manuel Medina Mora, chairman and CEO of Citi Latin America and Mexico, as well as to Raymond McGuire and Alberto Verme, co-heads of global investment banking, according to a Reuters report.

Wells Fargo has named three internal bankers to work in its global correspondent banking group. The San Francisco-based bank announced February 20 that **Susan Rico**, **Rita Mendoza**, and **Rosamaria Gonzalez** will now be working mostly on relations with Mexican financial institutions. Rico was named senior relationship manager for Canada, Mexico, and Iberia, while Mendoza and Gonzalez were named relationship associate and relationship manager in the unit, respectively. All three have been with Wells Fargo more than ten years.

Featured Q&A

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options. Third is the Congress, which ought to look for additional ways to permit diversification. In my personal opinion, I think they should raise the 20 percent limit on international investment because it has proved to be an effective diversification mechanism. I believe the next step should be to raise the limit to 30 or 40 percent and see how the market evolves and then keep raising it as long as it's reasonable and beneficial to the system."

A **Guest Comment: Tapen Sinha:** "There are a host of regulatory changes coming into effect on March 15, 2008 for the Afores—just as Mexico is poised to become the largest private pension portfolio country in the entire Latin American region in less than two years. First, reports to [regulatory authority] Consar for comparing Afores used to be

based solely on management fees. It did not matter what the rate of return for each Afore was. Now, however, they will be compared based on a net rate of return that takes into account both management fees and the return of each Afore up to today. Until recently, with more than 90 percent of Afore investment in short-term government bonds, the differential in the rates of return was small. Now, with the bigger latitude of investment portfolios, the difference in portfolio management will show very clearly. Thus, it would be time for the smaller, less profitable Afores to merge—as we have been observing in the past year or so. Second, movement between Afores by affiliates will be restricted. Thus, it will no longer be as easy to switch Afores frequently. Mexico has the highest rate of movement of affiliates from one fund to another. In 2007, one in every six affiliates changed fund affiliation. In comparison with the

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dom in Cuba." Democratic Senator Barack Obama said that "if the Cuban leadership begins opening Cuba to meaningful democratic change, the United States must be prepared to begin taking steps to normalize relations and to ease the embargo of the last five decades." Democratic Senator Hillary Clinton said she would work with partners toward peaceful democratic change in Cuba, and said the US "must pursue an active policy that does everything possible to advance the cause of freedom, democracy, and opportunity in Cuba."

Peru Declares State of Emergency Amid Deadly Protests by Farmers

Peru's government declared a state of emergency on February 19 after at least four people died in a nationwide farmers' protest that left thousands of people stranded behind blocked roads and railway lines without food or water for up to 48 hours. Cabinet Chief Jorge del Castillo said the government put the armed forces in charge of three provinces after police clashed with protesters, according to Bloomberg News. "The state can't remain impassive faced with this situation," del Castillo was quoted as saying. "These measures are severe, but absolutely necessary to safeguard order in the country." One protester died in a shootout with bus passengers on the north coast, while three others were killed in clashes with police, local radio reported, according to Bloomberg News. In the wake of the passage last year of a free trade agreement with the United States, farmers are pushing for state subsidies. They are also demanding lower prices for fertilizers and a halt to farm seizures by banks.

Economic News

Mexican Economy Grew 3.8 Percent in Fourth Quarter

Mexico's economy expanded a higher-than-expected 3.8 percent in the fourth quarter, led by growth in the service sector, the government said February 19. The expansion occurred despite an economic slowdown in the United States, which buys

about 80 percent of Mexican exports, as greater economic stability and lower interest rates have boosted consumer spending and borrowing in Mexico. Economists pointed to Mexico's fourth quarter economic data as an indication the country is prepared to weather an impending economic recession in the US. Services, accounting for more than two-thirds of Mexico's economy, grew 4.9 percent in the fourth quarter, led by a 10 percent jump in transportation and communications and a 5.3 percent increase in financial services, real estate, and insurance services, according to Bloomberg News. The industrial sector expanded 1.8 percent, while manufacturing grew 1.5 percent. For full-year 2007, the Mexican economy grew 3.3 percent, down from 4.8 percent in 2006. The government expects the economy to expand by about 2.8 percent this year.

Venezuelan Economy Grew 8.5 Percent in Fourth Quarter

Venezuela's economy grew 8.5 percent in the fourth quarter of 2007 compared to the same period of 2006, the country's central bank said in a Web site statement on February 21. At constant prices, the economy grew 8.8 percent, 7.6 percent, and 8.6 percent in the first three quarters of the year, resulting in an annual expansion of 8.4 percent for the entire year. The central bank said strong internal demand drove the growth in the fourth quarter. As a consequence of nationalizing the state telecommunications company, CANTV, and electric utilities last year, the public sector grew 14 percent, while the private sector grew 4.8 percent. While Venezuela's oil resources are fueling the economic boom, inflation in the country is the highest in Latin America, coming in at well over 20 percent and even could reach 40 percent in 2008, according to some analysts. And the ability of PDVSA, the national oil company, to sustain production levels for the mid to long term has been questioned. PDVSA said earlier this week that its profit fell 69 percent in the first half of 2007 to \$896 million, Bloomberg News reported. Overall revenue at PDVSA fell to \$42.9 billion in the period, down \$7.96 billion from a year earlier.

ECONOMIC BRIEFS

Argentine Economy Grew 9.7 Percent in December

Argentina's economy grew 9.7 percent in December compared to the same month a year earlier, the government said on February 20, according to Reuters. The government also confirmed that economic growth reached 8.7 percent in 2007, the fifth straight year of growth over 8 percent. The country's economy was driven by strong consumer spending last year, as well as by automobile and steel production. Economic growth is expected to slow to about 5 percent this year.

Brazil's Real Currency Rises to Eight-Year High

Brazil's currency, the real, rose 0.52 percent on February 20 to an eight-year high of 1.725 reais per US dollar, Reuters reported. The currency gains came as foreign investors sold dollars to buy local securities on the **Sao Paulo Stock Exchange**, whose main index rose 2.33 percent to 63,747.49 points, the strongest level since December 28. Brazil's strengthening currency has helped hold down inflation to its current level of about 4 percent.

Construction in Panama Grew 25 Percent in 2007

Construction, the fastest-growing sector of Panama's economy, grew 25 percent last year, fueled by the Panama Canal expansion and new high-rise apartments, Bloomberg News reported on February 20, citing Panama construction industry group head Michael Fernandez. Fernandez said "there is no bubble" and that Panama is unlikely to see a real estate bust like that in the United States. "The world has discovered Panama, and now they are investing," he said.

Featured Q&A*Continued from page 3*

region, this is by far the highest turnover. Turnover is costly to the system, and new rules will slow it down. All of this would give a clear long-term advantage to the large funds with almost locked-in affiliates. Whether that will induce them to reduce their fees remains to be seen."

A Guest Comment: León Bendesky: "The pension funds reform of 2004 was controversial from its very origin. The privatization of these funds was intended to deepen the financial system and to transfer the assets to the private sector, but also to start resolving the high indebtedness of the Social Security Institute (IMSS). The results are still not very clear, both in terms of the financial health of the IMSS and in those related to

“The upcoming reforms might have just marginal effects on the market.”

— *León Bendesky*

the building of the funds available to workers upon retirement. It is not clear whether the net returns on the invested funds of Afores' clients will be positive in the long run; that is, if they will be close to the expected value. Workers don't seem to be well informed about the evolution of their accounts. Consar seems too remote from the typical customer, and the upcoming reforms might have just marginal effects on the market, and even more so on the degree of active participation of affiliates whose wages are automatically deducted for deposit in the pension accounts. The total registered workers in the private pension system number over 38.5 million, but that includes those accounts that have been cancelled or have a zero balance. Inactive accounts might be of the order of over 22 million. The market is highly concentrated among few firms: the three mayor players represent 41 percent of the affiliates, the next five firms account for

another 40 percent, out of a total of 27 Afores. There are many open questions around the functioning of the system, its regulatory environment, and its real effects on the well-being of the workers."

A Board Comment: Rodrigo Heredia Matarazzo: "The recent reforms, including the elimination of the *saldo* commission, are obviously very positive for workers, and moreover allow an easier reading and understanding of funds' net returns, which therefore can now be compared directly. Regarding whether the Afores are prepared for this change and the creation of three new Siefores: the consolidation process underway clearly shows that, for some of them, the change is not so attractive without the *flujo* commission, given that in addition to not having this income there are significant added costs to create these three new funds. Obviously the biggest Afores will be able to create more scale in costs and will be able to cover them without much problem. Now, the challenge for fund managers will be to achieve better net returns, given that customers will be able to opt to switch to another Afore with better returns (the law allows it) thanks to the ease of comparing their performance. Thus, one can expect investment in capital markets to be higher, given that these types of instruments historically provide better returns than fixed income assets do."

Vicente Corta is a Partner at White & Case LLP in Mexico City and a former President of Consar.

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